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EX PARTE OR LATE FILED

March 7, 1997

William F. Caton, Secretary
Federal Communications Commission
1919 M Street, N.W.
Room 222
Washington, D.C. 20554

Re: Ex Parte Presentation — CC Docket No. 96-45

Dear Mr. Caton

On behalf of the Rural Telephone Coalition, I transmitted the attached memorandum by facsimile today to Paul Pederson and Charlie Bolle, two members of the state staff in the above-referenced Federal-State Joint Board proceeding.

In the event of any questions about this matter, please communicate with me or with David Cosson (NTCA) or Lisa Zaina (OPASTCO), who represent other associations that, with the association I represent, NRTA, form the Rural Telephone Coalition.

Sincerely,

Margot Smiley Humphrey

Margot Smiley Humphrey

NRTA · NTCA · OPASTCO

Rural Telephone Coalition

March 7, 1997

MEMORANDUM

To: Paul Pederson (573) 526-7341
Charlie Bolle (605) 773-3809

From: Rural Telephone Coalition

Re.: CC Docket No. 96-45 Federal Contribution Mechanism

The "Interstate-Only" Funding Crisis

We are concerned about the turn this federal funding mechanism has taken in the past two weeks. One senior FCC staff member told us point blank that the issue is now about a 25% interstate-only plan. We know a number of rural Senators and members of Congress are watching closely.

We will file this memorandum as an ex parte submission.

We look forward to talking with you.

The Problem

The Federal-State Joint Board in CC Docket No. 96-45 is at a crisis point for rural areas and rural states in implementing section 254 of the new telecommunications law. The crisis involves how to "size" and "fund" the new federal universal service fund (USF). The Joint Board's recommendation split on the question of how to fund the high cost portion of the USF, with a majority behind apportioning the responsibility for contributing to the federal USF based on the interstate and intrastate revenues of the interstate providers required to contribute under section 254(e). A minority backed apportioning the responsibility for federal USF contributions solely on the basis of relative interstate revenues. Only since FCC Chairman Hundt announced that he may support an interstate-only federal fund to avoid jurisdictional litigation, has it become evident that the original dispute was understood quite differently by advocates of the majority and minority positions. As a result, the Chairman's turn-around on an interstate-only

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measurement does not represent a true "meeting of the minds," is not likely to avoid litigation as he intended and threatens to preclude lawful implementation of the 1996 Act's universal service commitments, including "reasonably comparable" rural and urban rates and services and nationwide infrastructure development. The conceptual gap must be bridged quickly, since the May 8 deadline for universal service implementation is rapidly approaching.

The Conceptual Framework

The universal service standards and structure enacted in the 1996 Act, together with an understanding of past practices, provide the statutory and policy backdrop for any interpretation of what characteristics and results are necessary in the modified high cost mechanism. This does not mean that there is only one way to implement the Act, but rather that any implementation scheme must satisfy applicable statutory and legal criteria.

First, Section 254 requires the Joint Board to define the universal service to be funded by the federal mechanism and to provide a federal fund "sufficient to achieve the purposes of this [universal service] section." The state universal service role under the new law is distinct from the federal definition and funding mechanism. The federal (i.e. Joint Board developed) definition must be sufficiently supported by the federal mechanism under section 254(d) and (e). Section 254(f) allows state defined and funded universal service requirements and mechanisms that go beyond the federal definition, but a state's program must not burden or conflict with the federal universal service programs.

Second, the present funding mechanism makes use of an "expense adjustment" and a DEM weighting factor to recover through the interstate support process costs that would otherwise be allocated as intrastate costs (by virtue of the 25% gross allocator for nontraffic sensitive costs and the general unweighted DEM allocation factor used by large LECs). The costs that are separated are incurred for facilities or capabilities such as "dial tone" that are involved in both interstate and intrastate operations. States have not complained that interstate recovery of the share of total, unseparated costs allocated by the expense adjustment or by DEM-weighting impinges on state authority over intrastate rates and services or on intrastate high cost support mechanisms. The 1996 Act permits a separations-based mechanism. Indeed, the 1996 Act specifically requires the use of a section 410(c) joint board — the procedure developed for jurisdictional separations determinations — to design the federal support mechanism. Thus, explicit jurisdictional allocations of cost for federal high cost recovery could clearly remain a part of the federal universal service process. If continued such an allocation of total, unseparated costs for recovery from a fully explicit federal high cost mechanism would continue to relieve states of the burden of recovering that portion of costs in local or intrastate toll rates. It does not make any substantive difference whether the federal high cost recovery amount is characterized as interstate or intrastate costs. All the Act requires is that the mechanisms adopted through the joint board procedure must be "explicit" and "sufficient" and based upon the enumerated Universal Service policies. A state may adopt regulations consistent with the FCC rules and may expand the definition of universal service if it creates a sufficient separate support mechanism.

The important result for the statute is that the high cost amount needed to implement the joint board's definition of universal services will be spread across the nationwide network, by contributions from interstate service providers, not recovered from disproportionately high rates in high cost areas.

Third, it is well-settled both that there is no "correct" economic or legal answer to the question of how to allocate joint costs between the state and federal jurisdictions and that social policy is a valid consideration in making jurisdictional allocation decisions. In other words, the current basic 25% interstate NTS allocator is no less arbitrary than any other state vs. interstate split.

Fourth, the new carrier contribution mechanism applicable under section 254(d) to all providers of interstate telecommunications services is not tied by the statute to the "size" or the "sufficiency" of the federal universal service program. Indeed, the Joint Board recommendation would determine the "size" of the federal support as the level of costs identified by (1) calculating a forward-looking proxy model cost and (2) deducting a benchmark based on costs that would have to be covered through revenues for local, access and discretionary services before federal high cost support would become available (or, temporarily for rural LECs, by freezing their past support levels). Although the Joint Board members seem to have thought that the level of the benchmark would be varied depending on how the federal USF contributions are calculated, that relationship is not derived from the statute and cannot lawfully eclipse the express statutory mandate for "sufficient" federal support, regardless of the basis for collecting carrier contributions.

The Conceptual Gap

The dispute between the Joint Board minority and majority positions largely involves unstated assumptions and differences in interpretation of the jurisdictional problem and the proposals to resolve it. Thus, the dispute was ostensibly over how to "fund" federal universal service support in high cost areas — that is, how to parcel out the contribution responsibility among the providers of interstate services. The dispute took the form of a disagreement over whether the share of the federal funding from each interstate service provider would be apportioned on the basis of just the carrier's interstate revenues or both its interstate and its intrastate revenues. However, the two positions apparently rested on totally different understandings of what it would mean to decide this apportionment issue and whether or how the contribution measurement relates to the size of the federal support.

The minority view reflected the understanding that the question was solely about whether to take into account revenues from intrastate services in measuring a carrier's contribution to the federal mechanism. The fear was that measuring contributions against the total revenues of carriers providing interstate services would infringe upon state jurisdiction over universal service. The minority thought the total revenues measure would impair a state's ability to assess contributions based on intrastate revenues to support any supplementary definition and mechanism the state might adopt under section 254(f). Since the law expressly requires a federal mechanism that

provides a "sufficient" level of "specific" federal support to achieve the Act's universal service purposes, the total federal support amount may not, as a matter of law, be governed by how the contributions are apportioned. However, with apportionment that takes into account intrastate revenues, it could appear to potential contributors towards a state plan that support had already been contributed to the federal program from intrastate service revenues. However, any separate state plan should be for the support of services not included in the federal definition.

The concept of an "interstate only" mechanism espoused at the NARUC winter meetings by FCC Chairman Hundt, however, is much different. His proposal would reduce the "size" of the federal universal service fund, perhaps by raising the state-generated revenues benchmark, to limit interstate carrier contributions — unless total revenues were used to measure each provider's contribution to federal high cost support. Commissioner Chong noted the danger of the interstate-only approach: less federal support for state high cost areas. "If each state has to pull its own universal service wagon," she warned, "some states will have heavier wagons than others." In contrast the Joint Board recommended funding for school and other special discounts under section 254(h) based on interstate and intrastate revenues. The result of the narrow interstate-only interpretation would be to shift enormous high cost support burdens into the intrastate jurisdiction for states to recover through local and intrastate rates and intrastate high cost mechanisms. The most damaging effect of the Chairman's version of an interstate-only plan would fall on the most rural states.

Ensuring "Sufficient" Federal Support

The notion of limiting the federal support mechanism to an arbitrary level or raising the revenues benchmark to force states and their ratepayers to provide a greater proportion of support for high cost areas is fundamentally at odds with the statute. As noted, the mandate is for "sufficient" federal support to achieve purposes that include "reasonably comparable" rural and urban costs and services and nationwide access to information and advanced telecommunications. Moreover, the current "take" on an interstate-only approach is not consistent with the state concerns expressed by the Joint Board minority. Therefore, Chairman Hundt's offer to avoid a state and federal jurisdictional battle with his plan is not likely to satisfy most, if not all, rural states that the adverse effects are justified to protect theoretical state "jurisdiction" at the expense of higher state rate and support burdens for rural universal service.

The Rural Telephone Coalition urges the state and federal regulators to move promptly to a solution that will satisfy the statute and safeguard rural telecommunications users, as Congress intends. The best solution now, as the May 8 deadline approaches, is to craft a compromise that will adequately serve both state and federal concerns:

- It would be reasonable, for example, to adopt a federal plan which will be "sufficient" under the statutory standard — instead of grafting an arbitrary 25% ceiling on federal cost recovery or any other interstate-only proposal that restricts federal support because only interstate revenues are used to apportion federal support among contributors.

- To avoid being relegated to an insufficient "interstate only" plan, based on the Hundt proposal, that would overburden state ratepayers, it would also be reasonable for the opposing states to narrow their opposition to measuring the apportionment of federal fund contributions among carriers and allow the use of total revenues to apportion federal funding, to prevent arbitrage and remove perverse incentives to mislabel or even reroute traffic to avoid contributions under the federal program.

- To reconcile further the differing "takes" on how an "interstate-only" cost recovery approach would affect state universal service programs, the Commission should clarify that state programs could also apportion their intrastate support needs on the basis of the total interstate and intrastate revenues of intrastate providers, again to prevent arbitrage and remove perverse incentives to mislabel or reroute traffic, in this case to avoid intrastate contributions.